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SUBMISSION OF
CANADIAN PACIFIC RAILWAY COMPANY
to
THE ONTARIO COMMITTEE ON TAXATION

1. In response to the Committee's invitation, there are three areas of taxation in respect of which Canadian Pacific would like to comment, namely, corporation income taxes, gasoline and motor vehicle fuel taxes, and municipal property assessments.

2. As to corporate income tax, Canadian Pacific's submission is that, in addition to its other defects, this tax imposes an inequitable burden on, first, industries employing large amounts of capital in relation to annual sales; second, on service industries which provide their own facilities as compared to those which use facilities provided at public expense; and, third, on private companies as contrasted with crown corporations.

3. Dealing with the first point, some industries, by their nature (e.g. railways), require more capital investment than other industries (e.g. food processing), to produce equivalent annual sales of goods or services. The former must obtain from the sale of their products or service sufficient net revenues to cover not only the return which must be earned on the larger capital investment if the industry is to be viable but, in addition, the heavier income tax payable in respect of such higher net revenues.

4. This example will illustrate the effects:

(1) Company A is a service industry having an investment of $3 million to produce $1 million annual sales. Gross return on investment is 10%, and debt-equity ratio is 1/3 - 2/3.

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4. This example will illustrate the effects:

(1) Company A is a service industry having an investment of $3 million to produce $1 million annual sales. Gross return on investment is 10%, and debt-equity ratio is 1/3 - 2/3.

(2) Company B is a processing industry having an investment of $300,000 to produce $1 million annual sales. As before, gross return on investment is 10% and debt-equity ratio is 1/3 - 2/3.

Observe what happens:

	Company A	Company B
Annual Sales	$1,000,000	$1,000,000
Debt Capital	1,000,000	100,000
Equity Capital	2,000,000	200,000
Total Capital	3,000,000	300,000
Net Revenues Before Payment of interest or income tax	300,000	30,000
Interest on debt - 6%	60,000	6,000
Net available for Dividends	240,000	24,000
Corporate Income Tax at 50%	120,000	12,000
Corporate Income Tax as a Percentage of Annual Sales	12%	1.2%

5. From the point of view of a business man contemplating the venturing of capital in a prospective business, corporation income tax is an expense and he is not justified in embarking on such a venture unless he can anticipate charging such a price for his service or goods as will return to him a fair return on his capital after all expenses including corporation tax. Thus in the examples given, while Company A would have been warranted in embarking on the business, if there had been no income tax, if it could have anticipated total receipts of $880,000, it could only justify the venture, under income tax rates of 50%, if it could anticipate being able to charge its customers an additional $120,000, or $1,000,000 for the same goods or service. On the other hand, Company B, having the same turnover, only has to

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charge its customers an additional $12,000 by reason of corporation income tax.

6. While the assumption of annual sales of $1,000,000 in the case of each of these companies is, of necessity, arbitrary, it is a reasonable assumption having regard to the basic premise that Company A is a capital intensive industry and that Company B is not. It follows by definition that Company A's capital in relation to its sales will be relatively high compared to Company B's capital in relation to its sales. The actual relationships selected for our example are not remote from reality. Compare Canadian Pacific Railway Company whose gross revenues for its railway services in 1962 were $453,000,000 when its net investment in railway assets was $1,336,000,000 with Canada Packers Limited whose gross revenues from its sales in its 1963 financial year were $589,014,000 when its net investment was $104,000,000.

7. The foregoing illustration bears out the description of the corporate income tax as a concealed and capricious form of sales tax - concealed because it is unidentifiable, capricious because it bears with varying incidence on the users or consumers of various types of goods and services.

8. The illustration assumes a flat rate of 50%. If account were taken of the graduated corporation tax rates, the difference would be magnified.

9. It is apparent that in circumstances in which the tax can be passed on, it will bear with heavier weight on the consumers of goods and services requiring high capital investment for their production in relation to

annual turnover. This inequity of application arises from the fact that the tax is measured, not by production or consumption, but by the net profit from the business which tends to vary according to the amount of capital employed.

10. It is also self-evident that in general it will be more difficult to pass on the tax to the consumer when it involves a 12% increase in price, as in the case of Company A, than when it entails only a 1.2% increase, as in the case of Company B. Obviously, therefore, the likelihood is increased of the tax not being passed on, and resting instead on the owners or shareholders of the industry which must employ high capital investment in relation to annual sales volume. This in turn discourages future investment in the high-capital industry and distorts the allocation of economic resources.

11. Alternatively, for high-capital industries in which the capital investment has already been committed, present investment is penalized and the shareholder is discriminated against by having an inequitable burden placed upon him in comparison with other industries which do not require the use of large amounts of capital.

12. It follows, too, that what is true for the incidence of corporate income tax as a whole in relation to its effects as described above, is true for each addition to the taxation rate.

13. Turning now to the second point, it is apparent that another distortion occurs as a result of incidence of corporate income tax when, in a particular industry, one competitor provides its own facilities complete

whereas another utilizes facilities provided at public expense. The example of railways in competition with trucks, inland shipping and airlines will serve to illustrate this point. Railways provide their own right of way, roadbed, navigational and terminal facilities whereas for the other competing transportation agencies, corresponding facilities are provided in whole or in part by various levels of government at public expense. The MacPherson Royal Commission on Transportation recognized that the latter should be required, through appropriate user charges, to bear the cost of the publicly provided facilities and so recommended. Quite apart from that aspect of the matter, however, is the fact that, while user charges will reflect no cost of money except possibly interest at government rates, private investment by railways in their fixed facilities, the greater part of which must be represented by equity capital, attracts a burden in the form of corporation income tax. This burden falls upon either the users of railway service, or the shareholders of railways, or both, whereas the users and owners of competing transportation agencies entirely escape the attraction of any corresponding burden by virtue of the fact that corresponding fixed facilities, provided at public expense, incur no tax liability. Thus, the corporate income tax acts to discriminate against railways which provide and maintain their own facilities, and to confer a corresponding advantage on other transportation agencies which leave it to the state to supply them with highways, waterways and air terminals.

14. A third inequity created by the incidence of corporate income taxation arises in circumstances where

private companies are in competition with crown corporations in the same line of endeavour. Private companies are always under the necessity of having some part of the capital required for their undertaking supplied in the form of equity investment. The proportion which the equity part bears to the whole may vary according to the nature of the undertaking, the stability of its income, its maturity, the liquidity of its assets, etc. In the transportation field, equity investment usually represents more than one-half of the total capital of the undertaking. However, crown companies are not subject to the same discipline in respect of their financing. Their credit is backed by the government itself. Inability to meet interest obligations simply results in the incurring of a deficit to be made up from general tax revenues. Virtually all of their financing can be obtained through the issuance of debt securities, or by advances from the treasury, leaving only a nominal amount of equity paper which is entirely held by the government. Even this nominal amount is under no necessity of earning a dividend, since failure to do so will not impair the credit of the undertaking which is backed by the government itself. Indeed, the affairs of the crown company may be so arranged as to avoid the earning of a surplus over and above fixed interest obligations, and thus to avoid any liability for corporate income tax, or the legislative instrument creating the undertaking may exempt it from the incidence of corporate taxation.

15. Crown companies are thus in a special preferred position in relation to private companies which have to compete with them in the production and sale of goods and services.

16. As to gasoline and motor vehicle fuel taxes, it is the submission of Canadian Pacific that until the revenues from these sources are sufficient to pay the share of highway costs which can be fairly allocated to the users of highways, the tax should continue to be treated as a highway tax levied for the purpose of financing all such highway costs.

17. It has been noted that the Institute of Chartered Accountants of Ontario has suggested that the revenues from the gasoline tax, fuel tax, vehicle and driver license fees now exceed the related cost for transportation and communications. To test the accuracy of this statement and of the figures given in support of it, Canadian Pacific suggests that the Committee should obtain details of the costs and accounts to which the Institute refers.

18. It is the submission of Canadian Pacific that highway costs are not realistic unless they include proper charges for cost of money, maintenance, and as well a charge in lieu of taxes on the highway right of way. With respect to this latter charge, Canadian Pacific would mention that railways provide at their own expense the rights of way over which they operate and pay taxes to municipalities in which these rights of way are located. In the year 1963 Canadian Pacific paid in property taxes on its rights of way approximately the sum of $800,000. Under Section 4 of the Assessment Act highways are exempt from assessment and nothing is included in highway costs in lieu of property taxes. To this extent the users of the highways are being subsidized by the public purse

with the result that the railways, which are in competition with the users of the highway, are being discriminated against. It is accordingly the submission of Canadian Pacific that charges comparable to those being paid by railways for property taxes should be added to highway costs and assessed against the users of the highways. A similar situation exists in relation to waterways with which railways are in competition. Payments in lieu of taxes should be made by the government or authority responsible for the waterways and the lands and facilities connected with them to the Province and these payments should be added to the waterway costs payable by the users.

19. As to municipal property assessments, railway property is assessed under Section 46 of the Assessment Act. The roadway or right of way is assessed at its actual value according to the average value of land in the locality (46(2)(a)). Vacant land is assessed at its actual value as other vacant lands are assessed (46(2)(b)) and other railway lands are assessed at their actual cash value as they would be appraised upon sale to another company possessing similar powers, rights and franchises (46(2)(d)).

20. Section 46 was considered by the Select Committee on the Municipal Act and Related Acts and a recommendation was made at page 66 of the Second Interim Report dated March 1963 that all railway lands and property be assessed at its actual value in accordance with the provisions of Section 35.

21. There would seem to be no reason why vacant lands should not be assessed at actual value in accordance with Section 35 of the Act.

22. The right of way assessed under 46(2)(a) is generally a strip of land about 100 feet wide. In certain urban areas this strip runs through many varying types of property such as residential, commercial, industrial, public and vacant. As the assessment of this strip is related by statute to the assessment of the adjoining lands, the assessor is not permitted to give effect to the following factors:

(a) the restricted use to which the right of way can be put. Under the Railway Act which governs the use and operation of the right of way, the railway company cannot abandon the use for railway purposes without obtaining the authority of the Board of Transport Commissioners.

(b) the sale potential of such a narrow strip.

(c) terrain and plottage.

(d) the right of way is generally not contiguous to streets and even where it is the streets are a detriment to the right of way rather than an asset.

(e) the railway company provides its own fire and police protection and its property does not require these services to the extent they are required by other properties.

These factors all point to a lower assessment for railway right of way.

23. With respect to railway property other than the right of way and vacant lands, which consists largely of terminal yards and station grounds, the following factors must be taken into consideration in any assessment of them:

(a) these properties were in many cases acquired when the railway was first constructed and subsequently the towns and cities developed around them.

(b) they form part of a transcontinental railway system and can only be partially transferred to other districts at very great expense. Such transfer may entail, among other things, the revision of all connections to the properties and cause dislocation not only to the railway but to industry.

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(c) these properties place less burden on all public services such as water, sewer, fire and police protection. Also the roads within these properties are supplied wholly at the expense of the railway company.

24. With respect to both right of way and terminal facilities, some clear statement of principle for the guidance of assessors would be desirable. This could be accomplished by stipulating that there should be a percentage differential between the assessed value of adjoining lands and the assessed value of the railway lands which would reflect the diminution in value of railway lands resulting from the factors mentioned in paragraphs 22 and 23. Alternatively, if the position of Canadian Pacific with respect to the taxation of highway property, namely, that it should accept a charge in lieu of taxes, is not accepted, then Canadian Pacific's submission is that properties used in connection with the operation of the railway should be exempt from assessment and taxation.

25. Section 46(1) refers to steam railway companies. Steam has now been supplanted by diesel power. It would seem that the section is intended to apply to all common carrier railway companies and it is submitted that an appropriate amendment should be incorporated in the section.

Dated at Montreal, Quebec, the 28th day of February, 1964.

CANADIAN PACIFIC RAILWAY COMPANY

per R A Emerson
Vice-President